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IN THE

Supreme Court of the United States

October Term, 1969

No. 1103

AMERICAN STEAMSHIP OWNERS MUTUAL PROTECTION AND INDEMNITY ASSOCIATION, INC.,

Petitioner,

against

ARTHUR L. LIMAN, As Trustee in Bankruptcy of A. H. BULL STEAMSHIP CO.,

Respondent.

BRIEF FOR RESPONDENT IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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February 9, 1970

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Statement

The bankrupt and seven other companies under common control filed petitions for reorganization under Chapter X of the Bankruptcy Act in May 1963. This action was commenced by the Chapter X Trustees in January 1968. After the companies were adjudicated bankrupt, respondent Trustee was substituted as plaintiff.

The judgment below declares the rights of the parties with respect to tort actions against the bankrupt, a New York corporation, within the coverage of a policy of indemnity insurance delivered in New York by petitioner, a New York corporation.

By the policy petitioner agreed to indemnify the bankrupt against any loss, damage or expense which it "shall become liable to pay and shall pay" resulting from liability for personal injury or death arising out of its ownership of a named vessel. The policy provides that claims thereunder "shall be subject to a deduction of $1,000.00 with respect to each accident or occurrence." It authorizes, but does not require, petitioner to assume the defense of any claim within the coverage of the policy.

During the Chapter X proceeding, an application by the Trustees for authority to retain special counsel to defend certain actions pending in Philadelphia was opposed by the Government on the ground that the estate would be diminished to the extent of the $1,000 deductible attributable to each case, and that this would violate the priority of the United States in the disposition of the assets of the estate. The Government's position was upheld in a report of the Referee in Bankruptcy (15a-18a),* which recommended denial of the application "without prejudice to renewal" (17a). That report quoted (17a) from an affidavit stating that the Trustees were hopeful that some arrangement concerning the "deductible" might be worked out "in order that the defense of the actions will not deplete the assets

* References followed by "a" are to pages of the appendix to the petition.

of the debtors in any way". The effort to work out such an arrangement led to the commencement of this action for a declaratory judgment.

Under the procedure approved by the present judgment, where the insurer elected not to defend a case, respondent may seek authority from the Bankruptcy Court to engage counsel to defend it, provided that the claimant has entered into an agreement to pay to the estate the first $1,000 of the amount of any recovery or settlement, and to accept therefor a general claim in that amount.* If such an agreement had been made by the claimant, the estate would defend the action and would pay the full amount of any settlement or judgment and the full amount of the costs incurred in the defense. The judgment below declares that petitioner would then become liable to pay to the estate the amount so expended by it less the sum of $1,000, and the fact that the claimant would repay $1,000 to respondent and receive a general claim therefor would be of no concern to petitioner.

Petitioner asserts (p. 7) that, by the approved plan, "the Trustee has effectively deleted the deductible provision from the idemnity contract notwithstanding that the premium was based upon the deductible." That statement is erroneous. The premiums paid by the bankrupt obligated petitioner to reimburse it for losses in excess of the deductible amount. The judgment requires no more. A $10,000 recovery by a claimant would render petitioner

* Where the bankrupt had expended a portion of the "deductible" amount, the claimant would repay only the difference between $1,000 and the amount so expended. For simplicity, however, it will be assumed that no expenses had been incurred prior to bankruptcy.

liable for $9,000, which is precisely what defendant undertook to pay and the basis upon which the premium was computed. On petitioner's construction of the policy, requiring the estate to absorb the $1,000, its liability in such a case would be $8,000, doubling the deductible amount.

The actual effect of adopting petitioner's position would be more far-reaching. Judge Mansfield correctly observed (7-8a) that the result "would be to enable it to escape payment of judgments possibly running into many thousands of dollars solely because the estate, due to its insolvency, is unable to pay out of its own funds the relatively few thousand dollars required to satisfy defendant's concept that the assured must 'absorb' the deductible." The judge held that the insurer is not entitled "to the windfall sought by it at the expense of the ultimate beneficiaries of the policies" (11a).

Reasons for Denial of the Petition

The District Court, citing *Wilburn Boat Co.* v. *Fireman's Fund Ins. Co.*, 348 U.S. 310 (1954), treated the construction of the policy as a question of state law. It held that the result for which petitioner contended " 'would be contrary to the purpose and spirit' of New York law" (10a). The Court of Appeals, in a brief memorandum, agreed with Judge Mansfield's "well-considered opinion" and stated that it "can find nothing to add" (2a).

The courts below thus decided a question of state law presented in a situation which is certainly not one of common occurrence. No claim is made that their decision con-

flicts with those of other circuits or with any applicable decision of this Court. The petition (pp. 2-3), however, seeks review on questions stated to be presented under Sections 70a and 64 of the Bankruptcy Act, 11 U.S.C. §§110 and 104. It is submitted that petitioner's reliance on those sections is wholly misplaced. The judgment below in no way contravenes either section.

The petition also advances other supposed reasons for granting the writ which are not encompassed in the statement of questions presented (see Rule 23(1)(c) of this Court), and which will be shown to be plainly without merit.

I

Because Section 70a of the Bankruptcy Act vests the Trustee with title only to such property and contract rights as the bankrupt had, petitioner asserts that the courts below exceeded their power by according to the Trustee a right which the bankrupt did not have. In this contention, petitioner misreads the opinions. Their approval of the Trustee's method of dealing with the deductible provision of the policy was not predicated upon the fact that respondent is a Trustee in bankruptcy. They applied a rule of New York law which they found in cases where there was no bankruptcy. In one of those cases, quoted by the District Court, it was stated that the insured "was at liberty, so far as the defendant [insurer] is concerned, to borrow the money and pay the judgment even though it was insolvent or on the verge of insolvency," *Employes Liability Assur. Corp.* v. *International Milk Products Co.*, 192 App. Div. 88, 91 (1st Dep't 1920). The rationale of the state cases, that

the financial status of the insured is of no concern to the insurer, is not one which confers on a bankruptcy trustee any right greater than that of the original insured.

It is obvious that a solvent insured could not obtain from the injured claimants the type of agreement which the trustee proposes to offer to the plaintiffs in the pending actions. The plan approved by the judgment below is a practical accommodation of the interests of the Trustee and the claimants to the reality of an insolvent situation. It was approved below because the courts concluded that, under state law, it was one which the contract permitted the insured to adopt if it could get agreement from those who were suing it. The scope of a trustee's rights under Section 70a of the Bankruptcy Act did not enter into the decision. No issue under that section is presented.

II

Petitioner's effort to raise an issue under Section 64 of the Bankruptcy Act must likewise be rejected. Under that section, payment by the Trustee of litigation costs of $1,000 would undoubtedly constitute an expense of administration. Petitioner apparently contends that the section is therefore violated by a procedure which, yielding to the Government's objection, saves the estate that expense.

First, it is submitted that petitioner has no standing to raise this issue. The respective rights of the priority and general creditors are a matter of internal bankruptcy administration which do not concern a potential debtor to the estate. Since it is undisputed that, if the costs were borne by respondent, petitioner's liability would be in

exactly the same amount as under the present judgment, the alleged error does not prejudice petitioner.

Secondly, assuming that petitioner may raise the question, its position is wholly without merit. The approved plan does not violate Section 64 of the Bankruptcy Act but, on the contrary, serves to effectuate the underlying statutory policy.

The tort claimants are general creditors, standing behind the Government. The insurance policies, for which the bankrupt paid, are an asset of the estate which can be realized only after those general creditors are paid. They can be paid ahead of the Government only to the extent that the trustee can obtain indemnity. To the extent that such indemnity is not complete, the present judgment would charge those general creditors with the cost of bringing into the estate the insurance proceeds from which they, and they alone, are to benefit.

The fact that the cost of defense would be an administration expense does not make it any the less one which would be incurred solely for the benefit of the tort claimants. That fact, however, creates an obvious interest on the part of the Government to prevent the incurring of such costs for the benefit of a subordinate class of creditors. The effect of the plan is to preserve, rather than alter, the order of priorities created by the Bankruptcy Act. It enables the Trustee to discharge his statutory duty of realizing on the policies as an estate asset without incurring expenses which would reduce the sum payable to the creditor which has priority over the tort claimants.

III

Petitioner briefly and vaguely alludes (p. 12) to the expanding concepts of liability in maritime personal injury litigation and consequent importance of marine insurance. These references do not state a ground for granting review. The petition does not suggest that any governing provision of maritime law is involved in this case. It recognizes (p. 13) that the decision below rests on state law, and it does not dispute the applicability of that law.

Petitioner's suggestion (pp. 12-13) that the plan approved below is inequitable to maritime workers and offends the traditional protection afforded by the federal courts to seamen is certainly misplaced. The judgment below makes it possible to extend to those personal injury claimants the benefit of the bankrupt's insurance. If petitioner were to prevail, its resulting windfall would be at the expense of those claimants. Seamen, not insurance companies, are the wards of admiralty.

IV

The only real issue in the case, though not one encompassed in petitioner's statement of the questions presented, is whether New York law was properly applied in construing the instant insurance policy. We submit both that the issue does not warrant determination by this Court and that the state law was properly interpreted and applied.

Petitioner relies primarily on the fact that Section 167 of the New York Insurance Law, authorizing a direct action by an injured person against the liability insurer of

an insolvent insured, is inapplicable to marine protection and indemnity insurance policies. The denial of that remedy, however, certainly does not negate the policy reflected in the New York cases, on which Judge Mansfield relied, dealing with other situations in which the statute was not involved, *Henegan* v. *Merchants Mutual Ins. Co.*, 31 App. Div. 2d 12 (1st Dep't 1968); *Employers Liability Assur. Corp.* v. *International Milk Products Co., supra; Campbell* v. *London & Lancashire Indem. Co.*, 168 N.Y. Supp. 300 (Sup. Ct. 1917). Petitioner is mistaken in contending (pp. 9, 15) that the rule of these cases, that the source of the moneys paid by the insured is of no concern to the insurer, applies only to liability policies indemnifying against "loss" and not to those requiring payment by the insured. The latter type of policy was involved in the last two of the cited cases. Indeed, in the *International Milk Products* case quoted above (p. 5), the court expressly described the policy as "one of indemnity with respect to damages and not for liability."

The position taken in the New York cases finds support in decisions in other jurisdictions. See *Herbó-Phosa Co.* v. *Phila. Cas. Co.*, 34 R.I. 567, 84 A. 1093 (1912); *Hoagland Wagon Co.* v. *London Guar. & Acc. Co.*, 201 Mo. App. 490, 212 S.W. 393 (1919); *North American Acc. Ins. Co.* v. *Newton*, 57 Can. S. Ct. 577, 6 A.L.R. 1236 (1918). *Cf. Georgia Cas. Co.* v. *Bowron*, 233 F. 89 (5th Cir. 1916).

It is submitted that the law of New York was properly construed and applied by the Courts below. No reason appears for review by this Court of the narrow issue of state insurance law which they decided.

Conclusion

For all of the reasons hereinabove set forth, the petition should be denied.

Respectfully submitted,

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